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PLANNING AND COMPLIANCE FOR DUAL NATIONALS ISSUES FOR U.S. CITIZENS RESIDING IN THE UK

PATRICK HARNEY

Forsters LLP | 31 Hill Street | Mayfair | London | W1J 5LS
T: +44 (0)20 7863 8333 | F: +44 (0)20 7863 8444
www.forsters.co.uk

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PLANNING AND COMPLIANCE FOR DUAL NATONALS - ISSUES FOR U.S. CITIZENS RESIDING IN THE U.K.

1. Introduction

The vast majority of US citizens who are resident in the UK are likely to be UK resident non-domiciled individuals ('**RNDs**') from a UK tax perspective. I shall use the term US RNDs to refer to US persons who are UK resident but not domiciled there.

What I would like to do today is to focus on some of the key issues that affect US citizens who are resident in the UK. These are:

(a) The Finance Act 2008 changes to the remittance basis of taxation and the £30,000[1] remittance basis charge

(b) Tax consequences of UK citizenship

(c) An overview of the key UK inheritance tax rules that the US estate planner needs to be aware of when advising a US/UK couple

(d) Benefits of excluded property trusts for US RNDs

(e) Nightmare on Planning Street: Interaction of US and UK tax rules using a case study

(f) The impact of the Tax Reliefs Unemployment Insurance Reauthorization and Job Creation Act 2010 for US citizens residing in the UK

(g) Issues for US grantor trusts where the grantor/sole trustee moves to the UK

2. Overview of the remittance basis of taxation and the £30,000/£50,000 charge

US RNDs are a subset of RNDs and so in order to consider the issues for US RNDs, it is first necessary to consider the post April 5th 2008 tax regime applicable to RNDs generally. Subsequently I shall focus on the specific issues affecting US RNDs.

Application to RNDs generally

2.1 RNDs are entitled to claim the remittance basis of taxation. The remittance basis of taxation entitles the taxpayer to be subject to UK taxation on his UK source income and gains and his foreign income and gains to the extent that they are remitted to the UK. Subject to the exception referred to below, if a RND chooses not to make a claim to be taxed on the remittance basis, all of his worldwide income and gains, wherever arising and whether brought into the UK or not, will be taxed in the UK (subject to the provisions of any double tax treaty). Therefore, it is important for RNDs to decide whether or not to claim the remittance basis.

2.2 RNDs who have been resident in the UK for at least 7 out of 9 tax years will have to pay the £30,000 charge if they elect to be taxed on the remittance basis. However, the seven

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[1] From April 6th 2012, the £30,000 remittance basis charge will be increased to £50,000 for taxpayers who have been UK resident in 12 out of the last 14 UK tax years. In the remainder of this paper, references to the £30,000 charge should be construed accordingly.

out of nine year rule is often a trap for the unwary and in an extreme case the charge could commence after just over six actual years of presence in the UK[2].

2.3 If a RND decides to claim the remittance basis for the tax year 2011/12, the claim must be made by October 31st 2012 if completing a paper tax return, or by January 31st 2013 if completing a return on-line. The RND will normally have to make a payment by January 31st 2013 of £45,000, being the £30,000 charge plus £15,000 as a payment on account for the tax year 2012/13, assuming he anticipates that he will be UK resident in that tax year and claim the remittance basis. During the tax year that the RND has made the claim, he or she will not be entitled to the UK personal tax allowances[3], or the annual exemption for capital gains. It will therefore be necessary to calculate whether an election is appropriate.

2.4 RNDs will be required to "nominate" the source of unremitted foreign income or gains on which the charge will be paid. Once the source has been nominated, it will be important to ensure that none of the monies from that source are remitted to the UK, either deliberately or inadvertently. If the nominated income or gains are remitted, it might appear that no tax charge arises. However the practical reality is different; the remittance of the nominated amount will be deemed to be a remittance of the RNDs other foreign income or gains. Further, ordering rules will apply to determine what is remitted in a tax year which, it appears, will affect the present tax year and all future tax years as well. The ordering rules apply to the extent of the actual remittances of income or gains and they operate on a "worst first" basis, treating income as being remitted prior to capital gains and capital. [4]

2.5 Due to the uncertainty of the ramifications of remitting the nominated amount (in full or in part) we have recommended to our (non-US) RND clients that a separate, interest-bearing account is set up outside the UK to provide the RND with a source of income which will never be remitted. If the amount in this account is relatively small this should not create any inconvenience. All that is necessary is that the relevant account should generate some interest; £1 by the end of the tax year will be sufficient. The legislation provides that where the source of income or gains is insufficient to create a tax charge of £30,000, the charge is nonetheless increased to £30,000.

2.6 Provided the RND pays the £30,000 charge direct to HMRC from a foreign bank account (not being the nominated source), the payment will not itself be treated as a remittance.

2.7 Where more than one member of a family is potentially subject to the remittance basis charge, it will be worth considering whether the family's affairs can be restructured to limit the payment of the charge to one family member.

2.8 There are ordering rules if RNDs remit monies from mixed accounts – broadly monies giving rise to the highest rate of tax are deemed to be remitted first. RNDs should

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[2] For example, say that an individual arrives in the UK on April 1st 2009. He will be subject to the £30,000 remittance basis charge from April 6th 2015 even though he will only been in the UK for 6 years and 5 days at that point!

[3] In the case of taxpayers with taxable income over £112,950, the loss of personal allowances will occur anyway and so this would not be an actual cost of claiming the remittance basis.

[4] From 6 April 2012 the rules on nominated income are being simplified so that individuals are allowed to remit up to £10 of overseas income or capital gains which they have nominated for the purposes of the annual remittance basis charge without being taxed on that remittance and without being subject to the ordering rules.

therefore consider opening a number of different bank accounts in order to segregate different types of income (i.e. income which carries tax credits from that which does not) and the proceeds of sale of investments sold at a loss, no gain or a gain. This will enable them to choose in which order they remit monies to the UK to give themselves the most favourable tax result.

2.9 From April 6th 2010, income above £150,000 is subject to income tax at 50%. In the UK Budget 2012, the UK Chancellor announced that this rate will reduce to 45% from 6 April 2013.

Specific issues for US RNDs

2.10 Because US persons are taxable on their worldwide income and gains in the US, claiming the remittance basis in the UK will only be beneficial to the extent that the UK effective rate of tax that would have been paid on that income is higher than the US effective rate.

2.11 From the time that the £30,000 remittance basis charge was introduced in April 2008 until August 2011, there was uncertainty as to whether the IRS would permit a credit for the payment of the £30,000 against the US income tax liability of the US RND. In August 2011 the IRS issued a Revenue Ruling 2011-19 which states that the £30,000 charge can be taken as a foreign tax credit by US RNDs. This Revenue Ruling is good news for US RNDs and it may change their decision on whether to pay the remittance basis charge in the future, rather than subjecting their worldwide income and gains to UK taxation.

2.12 In addition, US RNDs who have paid the remittance basis charge of £30,000 in 2009 and 2010 and who have already filed these US returns should consider with their US/UK accountant whether these US tax returns need to be amended.

2.13 With non-US top rate taxpayer RNDs, the decision on whether to pay the £30,000 charge is based on simple maths: will the non-UK income exceed £60,000 or will the non-UK capital gains exceed £107,143? Where the RND is a US person, the issues are much more complex. The US RND must pose himself the following questions. Will the claiming of the remittance basis, factoring in the potential availability of the £30,000 remittance basis charge as a credit result in a lower overall income tax liability for the US RND? Can he afford to fund his UK spending requirements without resort to non-UK income on which he has claimed the remittance basis? In every case, the US RND will need to sit down with his US/UK accountant in order to examine these questions.

2.14 Now that we know that the IRS allow the credit, it might seem at first glance that the US RND taxpayer will pay the higher of the two country's effective tax rates and that double taxation should be avoided under the treaty. If only life was so simple! Unfortunately, the US and the UK treat common forms of income and gains differently for tax purposes. Examples of this include:

- Interest earned on US municipal bonds are tax exempt in the US but are subject to income tax at 40% (or 50% depending on the taxpayers level of other income) in the UK.

- The US rate of tax on disposals of collective investments in US mutual funds is currently 15%. Under UK rules such disposals are taxed as offshore income gains

at the income tax rate of 40% (or 50% depending on the taxpayer's level of other income) unless the fund is a 'reporting fund[5]' for UK income tax purposes.

- Remittances of US qualifying dividends as with remittances of all non-UK dividend income by remittance basis users are taxed at 40% (or 50% depending on the taxpayer's level of other income) in the UK. Such dividends are taxed at an effective rate of 25% (or 36.11% depending on the taxpayer's level of other income) in the UK in the hands of non-remittance basis users.

- In the UK, a principal private residence that is occupied as such or deemed to be occupied as such is fully exempt from UK capital gains tax. There is only a restricted $250,000 exemption available in the US.

2.15 Ultimately whether a US RND chooses to pay the £30,000 charge will depend on the nature of his/her assets and his/her sources of income. In depth calculations by US/UK specialist accountants will be needed to determine if paying the £30,000 will result in overall US/UK tax savings.

2.16 Although non-US RNDs can delay making a decision on whether to pay the £30,000 charge for the UK tax year 2011/12 until January 31st 2013, this is not so for US RNDs. In fact US RNDs may need to have made this decision as early as April 15th 2012. This is because making a claim for part or all of the £30,000 charge on a 2010 US tax return may involve "re-sourcing" (under the UK/US double tax treaty) US income as foreign income in order to claim credit for the £30,000 charge, this in turn may reduce the amount of US tax owed at April 15th 2012.

3. Tax consequences of UK citizenship

3.1 It should be noted that in the opening sentence of this paper I have referred to US citizens who are '*resident'* but not*' domiciled'* in the UK. I have not referred to US citizens who are or are not also UK '*citizens'*. UK citizenship does not confer UK residence or domicile for tax purposes. It is merely one of the factors that may be taken into account in determining whether someone is domiciled in the UK.

3.2 In the UK the tax connecting factors are domicile and residence. UK domicile confers a liability to UK inheritance tax on worldwide assets. When a person is a UK resident, their domicile determines whether they are entitled to access the remittance basis of taxation. Where a person is UK resident but not domiciled he may file his tax return as a remittance basis user and only be subject to tax on UK source income and capital gains and non-UK income and gains only to the extent they are remitted to the UK. In summary, citizenship of itself does not confer a tax liability.

3.3 UK citizenship has some limited relevance for tax purposes in the circumstances described below:

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[5] 'Reporting fund' is a new term for offshore funds from a UK perspective, the returns on which are subject to capital gains tax treatment which is currently more favourable than UK income tax rates of 50%. It replaces the term 'distributor status fund' as part of the changes to the offshore fund rules. A number of US focussed investment mangers in London provide access to US mutual funds that have obtained reporting fund status for UK purposes. Of course, as always, care needs to be taken not to let the tax tail wag the commercial dog but where there is a sound investment rationale for investing in a particular mutual fund in any event, the fact that it has reporting fund status is a significant attraction when compared with a fund of equal commercial outlook that does not have reporting fund status.

Article 1(4) of the US/UK Income Tax Treaty provides:

"Notwithstanding any provision of this Convention except paragraph 5 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Residence)), and by reason of citizenship may tax its citizens,, as if this Convention had not come into effect."

This of course preserves the right of the US to tax its citizens. It does not mean that the UK taxes its citizens by reason of citizenship. The treaty says the UK "may" tax its citizens by reason of citizenship but UK domestic tax law does not do this.

It is interesting to note the contrasting wording in Article 5(1)(b) of the US/UK Estate Tax Treaty which provides as follows:

"*Sub-paragraph (a) [the paragraph that states that only the country of domicile can tax non- Immoveable Property and non- Business Property of a Permanent Establishment] shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State."*

The income tax treaty wording merely states that each State may tax its citizens, whereas Article 5(1)(b) of the Estate Tax Treaty states that the preceding relieving provision "*shall not apply*". Accordingly the US-UK Estate Tax Treaty is an example of where UK citizenship might in some very limited circumstances confer a tax liability on an individual just because he is a UK citizen.

Example: Charles is a US citizen and domiciliary. Many years ago he worked in the UK and during that time he applied for and obtained a UK passport. He died owning shares in Tesco Plc, a UK company.

Article 5(1)(a) of the Estate Tax Treaty provides that only the country of domicile can tax the Tesco shares as they are not real estate or business property of a permanent establishment. However, Article 5(1) (b) provides that the preceding paragraph shall not apply because the decedent was also a national of the other State (the UK). Because the UK effective rate of inheritance tax is generally a lot higher than the effective US Federal estate tax rate, the acquisition of the UK passport by Charles in that situation has led to an increased tax liability for his estate. Except of course it would have been open to Charles to avoid this by holding his UK assets through a non UK corporation (subject to properly considering the impact of this on other US and UK taxes).

UK citizenship also has some relevance in the penultimate leg of the residence tie-breaker clause of UK tax treaties that are based on the OECD model. Articles 4(4)(c) of the US/UK Income Tax Treaty and Article 4(4)(c) of the US/UK Estate Tax Treaty provide that the if the preceding articles have not determined an individual's residence or fiscal domicile respectively, then the country of nationality shall determine it.

4. An overview of the key UK inheritance tax rules that the US estate planner needs to be aware of when advising a US/UK couple

I have set down below the key UK IHT rules that the US estate planner needs to be aware of.

4.1 UK resident and domiciled individuals are subject to UK taxation on their worldwide income and gains and are subject to IHT on their worldwide assets.

4.2 US RNDs who elect for the remittance basis of taxation are subject to UK tax on their UK income and gains and on their foreign income and gains to the extent that they are remitted into the UK.

4.3 RNDs who are not deemed domiciled[6] in the UK are subject to IHT on UK situate assets only[7]. If such individuals become deemed domiciled in the UK, they will be subject to IHT on their worldwide assets.

4.4 There is an unlimited spouse/civil partner exemption from IHT subject to the fact that where assets pass from a UK domiciled or deemed domiciled spouse/civil partner to a spouse/civil partner who is not UK domiciled or deemed domiciled, there is only a limited spouse/civil partner exemption of £55,000[8] available. In the UK Budget on March 21st 2012, the UK Chancellor, George Osborne announced that a consultation will take place about increasing the £55,000 figure to the prevailing nil rate band (currently £325,000) and permitting the non-UK domiciled recipient spouse to make an election to be UK domiciled for inheritance tax purposes. The earliest that any change is likely to happen is April 2013.

4.5 Individuals who are registered as civil partners under the Civil Partnership Act 2004 are treated as spouses for UK tax purposes. As I understand it, the US Federal authorities do not recognise civil partnerships and so civil partners are not entitled to the marital deduction for US Federal estate tax purposes. This is so even if the parties entered into a civil partnership in a state in the US that recognises them.

4.6 Where it is wished to obtain the spouse/civil partner exemption, assets must be passed to the surviving spouse/civil partner either absolutely or by giving them an "*immediate post death interest*"[9] ("**IPDI**") in the assets.

4.7 It is possible for a non-UK domiciled individual to shelter their non-UK assets from IHT by transferring them to an appropriately structured trust, an "**excluded property trust**"[10]. If this is implemented correctly then the non-UK assets in the trust will remain outside the IHT charge even if the settlor becomes domiciled in the UK[11].

4.8 The UK nil-rate band is £325,000 and is frozen until 5 April 2015, after which it will be indexed for inflation.

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[6] Under s267(1)(a) IHTA 1984, an individual is deemed domiciled in the UK if he has been resident in the UK for 17 out of the previous 20 UK tax years. An individual is also deemed domiciled if he has been domiciled under the general law at any time in the previous three years before a relevant event. Deemed domicile applies only for IHT purposes and for the purposes of the pre-owned assets income tax charge.

[7] Subject to possible treaty relief in a US/UK context in the case of assets other than:

- real estate; and
- business property of a permanent establishment: Articles 6 and 7 of the estate tax treaty.

[8] In a US/UK context, Article 8(3) of the estate tax treaty effectively provides a greater exemption to the extent of 50% of the value of property passing to a non-UK domiciled spouse from a spouse who is a US national (but UK domiciled).

[9] Broadly an interest in possession created under a will: s49A IHTA 1984.

[10] Under s48(3) IHTA 1984.

[11] This is not necessarily the case in relation to interest in possession trusts created before March 22nd 2006 in which the settlor or his spouse had an initial life interest: s80 IHTA 1984.

4.9 In the UK, it is possible to make an absolute and irrevocable gift that if structured appropriately, will avoid IHT if the donor survives the gift by seven years[12]. This is commonly known as a "**PET"** (potentially exempt transfer).

4.10 The gift of assets to any kind of trust, even a revocable[13] trust triggers an immediate lifetime IHT charge on the excess over £325,000, where the gift is within the IHT charge. Accordingly, in the case of US citizens, there are two primary ways in which they could fall into this trap:

(a) A gift into trust by a UK domiciled or deemed domiciled US citizen; or

(b) A gift into trust of UK assets by a US citizen.

4.11 This lifetime chargeable transfer on a gift into trust is a significant trap for the unwary with potentially catastrophic tax consequences and it reinforces the need to take UK advice any time that Americans are doing anything with trusts or otherwise, where there is a UK connection.

4.12 There is a UK inheritance tax regime that is potentially applicable to UK connected trusts, known as the "**relevant property regime**". Broadly, it involves an inheritance tax charge of up to 6% on every ten year anniversary of the trust's creation and up to 6% on exits of principal. Unless anti-avoidance rules known as the "gift with reservation of benefit"[14] rules apply, where assets are in the relevant property regime they are outside the beneficiaries' estates for IHT purposes. A more detailed note on the relevant property regime is contained in the Appendix.

5. Benefits of excluded property trusts for Americans living in the UK

5.1 The rate of IHT is 40%. An excluded property trust is a trust created by an individual who is non-domiciled in the UK consisting of non-UK assets. The benefit of an excluded property trust is that the assets are insulated from IHT even if the settlor/grantor of the trust subsequently becomes domiciled or deemed domiciled in the UK.

5.2 The question might be asked, is there any point in creating an excluded property trust for an American to save 40% UK IHT if they going to have to pay US estate tax anyway? For US citizens, the benefit of an excluded property trust is an IHT saving of 40% on the difference between the nil rate band amount in the UK and the US estate tax exempt amount. Therefore if an American creates an excluded property trust (which can be a grantor trust from a US perspective) it can effectively shelter their assets from UK inheritance tax even if they subsequently become domiciled or deemed domiciled in the UK. For the US tax years 2011 and 2012, the rate of US estate tax is 35% with a US$5m

[12] A potentially exempt transfer: s3A IHTA1984. After three years the rate of tax is tapered downwards.

[13] If a trust is revocable and the proper law of the trust follows section 603 of the Uniform Trust Code, it may be possible to take a position that the "trust" is in fact a nominee arrangement for the purposes of UK tax law. Section 603 UTC provides that where a trust is revocable and the settlor has capacity to revoke the trust, the rights of the beneficiaries are subject to the control of, and the duties of the trustee are owed exclusively to, the settlor. That being so, there may not in fact be a trust for the purposes of UK capital gains tax or inheritance tax. Everything will depend on the drafting and the applicable proper law. Some state statutes (e.g. California Probate Code section 15800) impose rules almost identical in effect to section 603 UTC. For further reading on this issue see *Kessler, Taxation of Non-Residents and Foreign Domiciliaries 2011-12* paragraph 72.11.

[14] Broadly, the UK equivalent of Section 2036 of US Tax Code.

exempt amount. Therefore, based on an exchange rate of $1.5904, their inheritance tax saving on the first $5m would be £1,127,545. In addition while the US Federal rate remains at 35%, they also save 5% of the excess of their estate over $5m.

5.3 Another advantage of a long term UK resident American having funded an excluded property trust during his lifetime is that it is not necessary to have the added complication of dealing with the US/UK treaty in relation to the assets in the trust fund on death.

6. Nightmare on Planning Street[15]: interaction of US and UK tax rules using a case study

Brad and Florence[16] – UK family home

6.1 Brad is a US citizen and is married to Florence who is a UK citizen and domiciliary. They have two children who are both US and UK citizens. Brad moved to the UK ten years ago and Brad, Florence and the children are resident in the UK. Brad and Florence own an investment portfolio worth £15m. Brad and Florence contributed equally to the purchase of the portfolio and it is held by them in joint names (under a right of survivorship).

6.2 If Brad dies, although spouse exemption will be available in the UK, its US equivalent will not be available because Florence is not a US citizen, and so, there will be an immediate estate tax liability of 35% of the excess of the value of Brad's half of the portfolio over US$5m. Instead, Brad and Florence should consider severing the joint ownership in the portfolio so that they can dispose of each half by will and Brad's will could provide as follows:

- an amount equal to the US estate tax exemption (US$5.12m in 2012) in an IPDI for Florence with an overriding power of appointment in favour of the children; and

- the residue to a QDOT for Florence, with the QDOT also structured to be an IPDI from a UK perspective.

6.3 As Brad is a US citizen, his will will need to be drafted by a US attorney and reviewed by a UK lawyer.

Estate plan of UK spouse

Because Brad is a non-UK domiciliary, Florence's estate will only be entitled to the limited spouse exemption from IHT of £55,000[17]. Therefore if she leaves her half on an IPDI for Brad, there will be UK tax at 40%[18] on her death on the excess over £55,000

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[15] This is in fact the term used in paragraph 20.40 of the *Guide to US/UK Private Wealth Planning by Williams, Layman and Nicholson* to describe the situation where a UK domiciled decedent dies leaving a US spouse who is non UK domiciled.

[16] This case study is based on one used in an article by *Patrick Harney: Divided by a common language, Tax Adviser July 2008.* It can be located at http://www.forsters.co.uk/cmsfiles/pdf/PH_TA_0708.pdf.

[17] See paragraph 3.4. The law relating to the limited £55,000 spouse exemption may change by the time of Florence's death.

[18] In these circumstances, an election could be made for relief under Article 8(4) of the estate tax treaty to reduce the tax by 50%.

and further UK tax of 40% on Brad's death. If she left her half to Brad absolutely, she would avoid UK tax on his death (on non-UK situs assets if he dies non-domiciled) but it would suffer US estate tax. A preferable option is for Florence to leave her half on a discretionary trust for the benefit of Brad and the children which special US language built in so that it does not fall into their estates for US purposes. Admittedly this will trigger 40% tax on Florence's death but it is not taxed in the UK again except under the relevant property regime and provided the US lawyers have done their work correctly it will also be outside of the US estate tax net. Another advantage of the discretionary trust route is that if Brad has become UK deemed domiciled by the time of Florence's death, the trustees would have the option to appoint him an IPDI within two years and have it read back into the will under s144 IHTA 1984 so as to obtain the unlimited spouse exemption.

7. **What does the Tax Reliefs Unemployment Insurance Reauthorization and Job Creation Act 2010 ('the Act') mean for US citizens residing in the UK?**

7.1 The key points of the Act which are relevant for US citizens residing in the UK are as follows:

(a) A US$5m exemption (per spouse) from US federal estate tax, US federal gift tax and US federal generation skipping transfer tax;

(b) A transferrable exemption amount if one spouse's US$5m estate tax exemption is not fully utilized; and

(c) A top rate of estate tax at 35%.

7.2 The first point to note is that the increase in the US estate tax exemption amount makes excluded property trusts even more attractive for US citizens residing in the UK. As we saw before based on an exchange rate of $1.5904, the inheritance tax saving would be £1,127,545.

7.3 Previously the ability of US citizens who were domiciled or deemed domiciled in the UK to make lifetime gifts (structured as PETs from a UK perspective) was restricted by US gift tax considerations. As a result of the Act US$5m can be gifted during lifetime and provided the donor survives seven years of making the gift it will be free of death taxes in both countries.

7.4 In the example of Brad and Florence, Brad's Will provides that Florence receives an IPDI in the "pot" which contains an amount equal to the US estate tax exempt amount. The trustees have an overriding power of appointment in favour of their children. From a UK perspective the exercise of the trustees overriding power of appointment will be regarded as a PET by Florence which, provided she survives seven years from the trustees' exercise of the overriding power, will be free of UK inheritance tax. From a US perspective the appointments to the children are free of US estate tax since the appointments are within Brad's US estate tax exempt amount. On this basis, up to US$5m can be passed to the next generation free of death taxes in both countries. The provisions of the Act mean that it will be even more important that trustees consider exercising their overriding power of appointment during the surviving spouse's lifetime. However, this will ultimately be dependent on family circumstances and will need to be balanced against the asset protection benefits of keeping the inheritance in trust.

8. Trap for US grantor trusts where the grantor/sole trustee moves to the UK

8.1 In my experience, it is common for US persons to be the trustee of their own grantor trust. Whereas for US tax purposes, a grantor trust may just be "*another pocket in the pants*" of the grantor of the trust, this is not so for UK tax purposes. There are two specific issues in this regard that need to be flagged:

(a) The remittance basis of taxation does not apply to trustees. Therefore if a US person who is a grantor and sole trustee of his trust moves to the UK it will make the trust resident from a UK income tax and capital gains tax perspective with no remittance basis available. The trustees are treated as a continuing body of persons for UK income tax and capital gains tax purposes and as such are not entitled to the remittance basis of taxation. Hence they are subject to UK taxation on an arising basis.

(b) There is a capital gains tax exit charge where a UK resident trust ceases to be UK resident. Therefore if the US grantor and sole trustee of the trust decides to move back to the US, this will trigger a capital gains tax charge where the trustees are deemed to have disposed of all their assets at market value at the date of cessation of UK residence. It will not be possible to avoid the exit charge by winding up the trust prior to ceasing UK residence as this also causes a deemed disposal for capital gains tax purposes.

8.2 The practical way to deal with this is to appoint at least one non-UK resident trustee before the grantor moves to the UK so that under the UK income tax and capital gains tax trustee residence rules, the trust is not deemed to be UK resident provided that the grantor was not UK resident, not UK ordinarily resident and not UK domiciled when he created the trust[19].

8.3 If a position can be taken, that a trust is a nominee arrangement (see footnote 13), then the problems discussed in this paragraph can be avoided.

[19] Section 474 Income Tax Act 2007 and section 69 Taxation of Chargeable Gains Tax Act 1992.

APPENDIX
The UK Relevant Property Regime applicable to trusts

1. Territorial scope

   Once it is established that a trust is within the inheritance tax ('**IHT**') charge either due to the UK domicile of its settlor or the UK situs of its assets, it is necessary to consider whether it is a trust that is taxed under the relevant property regime ('**RPR'**) (a '**relevant property trust**').

2. A trust or settlement is a taxable entity in its own right and as such may be liable for IHT. A major change was introduced by the *Finance Act 2006*, which effectively ended the distinction between types of trust for IHT purposes, so any lifetime trust (other than a disabled person's trust) created after March 22nd 2006 is taxed under the RPR which previously applied only to discretionary trusts.

3. It is easier to set out the kind of trusts that are not relevant property trusts as all other trusts are now relevant property trusts. The trusts set down below are not relevant property trusts and are taxed under the old rules i.e. the rules applying to all interest in possession trusts before March 22nd 2006 whereby the life tenant is treated as owning the underlying assets for IHT purposes.

4. Trusts that are not relevant property trusts:

   - Life interest trusts in existence on March 22nd 2006 which continue to have the same life tenant;

   - New life interests carved out of pre-March 22nd 2006 life interests and created before October 6th 2008 and satisfying the conditions of s49B IHTA 1984 (known as "transitional serial interests" ("TSIs");

   - Immediate post death interests; broadly interest in possession trusts created under a will; and

   - Disabled person's trusts.

5. Any trust that does not come within the categories outlined at paragraph 4 is a relevant property trust. So, for example, any new trust created during a person's lifetime that is not a disabled person's trust is a relevant property trust.

6. Basis of charge for property held upon relevant property trusts

6.1 IHT is charged on relevant property, that is, settled property in a settlement (trust) in which there is no qualifying interest in possession (a qualifying interest in possession is one described at paragraph 4 above).

6.2 Put simply, an interest in possession ('**IIP'**) means that the trustees have to pay the trust income to a beneficiary, or allow the beneficiary to have use of trust assets. The old rules continue to apply to all IIPs in existence at March 22nd 2006 and to TSIs created before October 6th 2008, therefore on death the value of the trust assets is aggregated with the beneficiary's estate and subject to IHT. This is because for IHT purposes the beneficiary is treated as the absolute owner of his interest in the trust.

6.3 The IHT rules under the RPR are briefly summarised below:

- Creation of a settlement

  On the creation of a settlement or a gift into an existing settlement during the lifetime of the settlor there is an immediate IHT charge at a rate of 20% on the value of assets transferred into the settlement over the IHT nil rate threshold (£325,000 in 2012/13 and frozen at that level for the next two years).

  Relief is available for business property and agricultural property and for normal expenditure out of income where the relevant conditions are met. Should the transferor die within seven years of the transfer into trust, the tax rate is increased to the full 40%.

- Periodic and distribution (exit) charges

  Trusts within the RPR are subject to periodic charges on every tenth anniversary of the creation of the settlement at a maximum rate of 6% of the value of the trust assets over the nil rate threshold. There is an exit charge at a maximum of 6% on the value of the capital leaving the trust over the nil-rate threshold. There is no exit charge if property leaves the settlement within three months after the creation of the settlement or within three months of a ten year anniversary charge.